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Abstract

Reference Points-Change in Tastes

Myagkov and Plott.

When people do not feel confident about their understanding of a situation they will be conservative and choose inaction over action (i.e. *status-quo*): A natural feature of uncertainty, as opposed to risk, is the imagined existence of negative prospects that are possibly weighted so high that inaction results. *[Tis implies difficulties for the introduction of new products].* **With exposure to the decision environment comes a better understanding and as a consequence the imagined, possibly negative prospects, disappear and the other features of the decision process emerge.**

Conjecture 2. With experience, risk seeking in losses evolves into either risk-neutral or risk-averse behavior.

...individual decision rules seem to evolve and individual understanding of a situation and the attitudes of other individuals seem to undergo a transformation during the course of decisions and market activity.

The idea is that the individuals have a consistent set of preferences over states but such preferences only become known to the individual through thought and experience@@@.*(&&&)* ....With experience, behavior moves towards patterns choice behavior typical of the predictions of classics preference theory.

....The existence of which (concern for gains and losses) implies the existence of another fundamental feature of prospect theory, a reference point.

The conjectures reported here suggest that... features of prospect theory are present when people are confused. **...conservatism (i.e. the status-quo) is a consequence of incomplete understanding.** ...one implication of the conjecture is that the concept and importance of a reference point will also faint.

Cubitt, Starmer, Sugden

The principle of timing independence requires that an agent, if required to precommit to an action to be taken conditional on a prior act of nature, precommits to an action which would be chosen if the moment of choice

was delayed until after the act of nature###. *[The nature of dynamic choice and time consistency]****

Dynamic choices which satisfy *separability, timing independence, frame independence, reduction of compound lotteries imply* that Problems 1-5 (see text p. 1365) are equivalent. **Most common theoretical response to the evidence of a common ratio effect has been to develop static model, which permit that effect by relaxing the independence axiom of expected utility theory.** However, any theory which accounts for the common ratio effect *must*, also violate one of the four dynamic choice principles identified above. *[*Problem 5 is the *reduction of compounding lotteries]*

Segal (1987, 1989, 1990). Segal (1987), instead of the reduction of compound lotteries, advocates an alternative technique which rests on two principles: *reduction by substitution of certainty equivalents, and independence for sure prospects.*

The *independence for sure prospects* requires that for any consequences x_i, x_j, x_k,and $0 \leq q \leq 1$, if $x_i \succsim x_j$ then, $(x_i, x_k)(q, 1-q) \succsim (x_j, x_k)(q, 1-q)$.

As a result of these Segal's theory implies that Problems 1 and 4 are equivalent. Problem 5 is not equivalent to Problems 1-4 because the theory assumes that the choice between simple prospects is provided by the rank dependent utility theory.

Kraus, Sagi.

Another reason to avoid precommitment arrises if the decision tree, and thus the agent, cannot account for all contingencies; in such a case the agent may worry that she cannot prespecify a comprehensive plan at the initial date that would be subgame perfect. ****[Nature of dynamic decision making.]*

We assume that agents have well-defined and complete revealed- preference ordering over current choice alternatives; however, if asked to introspect about decisions that will be faced later, they can only partially order future prospects*(@@@).* *[i.e. future preferences are fuzzy?][Future perferences may be partiallyy orderd because his preferences for future commodities are fuzzy]***This is equivalent to stating that the agent cannot perform backward induction (dynamic programming) in the standard way** *(&&&).* **What we show is that the desire to take future decisions into account, whatever they may be, forces a preference for flexibility***(+++)[Is this contra to ###?]*

The main contribution of this paper is the demonstration that by combining partial orderings and a time consistency condition, an *inter-temporal* preference for flexibility and an associated subjective state space emerge in a natural way.

Sagi.

Existing theoretical models of **reference dependence** in the context of risky choice, known as **rank and sign dependent models**, have been largely motivated by the clear **preference for loss aversion.** These models ubiquitously specialize to preferences defined over wealth lotteries in which the agent assigns a value function to

prospects using non-additive probability weights and a **'utility' function defined over wealth changes from some reference point.**

The components of a prospect representing **gains versus losses (with respect to the wealth equivalent) are treated differently**-hence the 'sign' dependence. *[Are my refernce points of the same nature? Probably not].*

Consider a set of utility functions; when the reference point is at lottery e, an agent's values of a prospect, A, according to the least attainable expected utility is the difference between A and e. In particular, A will be preferred to the reference point e, if and only if the expected utility of A exceeds that of e for *every* utility function in a utility set. The last property is what gives rise to the status-quo bias and motivates referring to the reference point as the 'anchor'.

Gull

Starting with Strotz (1965) authors have analyzed decision-makers **tastes change over time.***[So change in tasetes has been studied before but the nature of change is not the same as the one I assume. In the literature differences in tastes occur because the agent faces temptation or prefers some prospects (on the basis of their outcomes) rather than others, or because he becomes a different type of individual over time. My agent changes because new technologically advanced goods are introduced in the market and he is not familiar with their properties, or he does not know the complementarity or substitutability relation of (particularly the new) commodities with the ones he already posesses. This must (a) strengthen the status-quo (%%%), (ii) increase the need for flexibility (+++), (iii) make preferences for future commodities fuzzy, (iv)cause future perferences to be partially ordered because his preferences for future commodities are fuzzy].* Typically the analysis postulates a distinct utility function for each decision date. The decision maker forms expectations as to how future decisions will unfold and maximizes current utility given those expectations. The resulting decision-making is said to display "dynamic inconsistency". That is the agent may prefer consuming c to c' tomorrow if he has the opportunity to commit to c today. But without such a commitment, chooses c' tomorrow.

The key question in the analysis is, how the decision-maker forms expectations about his own future behavior. Strotz proposed the "strategy of consistent planning", and argued that the decision-maker **will choose the optimal plan among those plans that he is willing to carry out in the future.** Peleg and Yaari (1973) treat each decision period as a distinct player and solve for Nash equilibria in the resulting **dynamic game.** O'Donaghue and Rabin (1999) argue that the decision-maker may **naively** believe that his future behavior will maximize current preferences.

In this paper, we propose an alternative approach to modeling changing preferences. Following Kreps(1979) and our earlier work on self-control (Gull and Pesendorfer (2001)) we define preferences over choice problems We give conditions on those preferences under which the decision-makers behavior can be described as envisioned by Strotz The advantage of our approach is that preferences over choice problems are - at least in principal - observable. Rather than speculating about

the appropriate model of expectation formation, we offer choice experiments that identify Strotz' model of behavior. Our approach... differs from the... literature on dynamic inconsistency on two dimensions: first, we take the **temptation interpretation** rather than the **changing of preference** interpretation to preference commitment. Second, we do not consider agents expectation of his future behavior a primitive of our model. Rather we focus on **revealed preference experiments** and derive expectation from observable behavior

[The relation between preferences over the commodity space and consumption preferences mus be reexamined. How can the inverse utility be as in Kreps and E-Z when we relate consumption preferences to the ordering of the commodity space? Should the utility function over commodities be considered as a technical relation in "home production"?(eg. a Cobb-Douglas production- utility function which produces household services?]